CHASE MANHATTAN BANK, N.A. *a*

v.

THE MERCANTILE CO-OPERATIVE THRIFT & LOAN SOCIETY LTD.

SUPREME COURT, KUALA LUMPUR
HARUN HASHIM SCJ
MOHD. YUSOFF MOHAMED SCJ
MOHD. JEMURI SERJAN CJ (BORNEO) *b*
[SC CIVIL APPEAL NO. 02-210 OF 1989]
27 APRIL 1992

UNINCORPORATED ASSOCIATIONS: *Registered under Co-operative Societies Act 1948 - Management committee gave pledge and authority to set off to bank - Amount due to bank by a private company incorporated under Companies Act 1965 - Authority to bank to set off any amounts standing to credit of society to amounts owing by the private company - Whether the giving of the pledge and letter of set-off ultra vires the society.* *c*

The issue in this appeal was whether the giving of the pledge and authority to set off by the management committee of The Mercantile Co-operative Thrift & Loan Society Limited in favour of appellant bank in respect of amount due by a private company incorporated under the Companies Act 1965 were *ultra vires* the society and not binding on it. *d*

Held:
[1] As there was no formal resolution of the committee of management of the society authorising the issue of the pledge and letter of set off and sealed with the seal of the society, the pledge and letter of set-off standing by themselves were insufficient. *e*

[2] The pledge and set-off documents in this case were financial commitments which are not covered by s. 32 of the Co-operative Societies Act 1948 and the society had no power to execute such documents.

[3] Accordingly, both the documents were *ultra vires* and *void ab initio.* *f*

[Appeal dismissed with costs.]

[**Bahasa Malaysia** Translation of Headnote]

PERTUBUHAN KOPERASI: *Didaftarkan dibawah Akta Pertubuhan Koperasi 1948 - Jawatankuasa pentadbir memberi ikrar dan kuasa untuk tolakan kepada bank - Jumlah yang harus dibayar kepada bank oleh sebuah syarikat persendirian yang ditubuhkan dibawah Akta Syarikat 1965 - Kuasa kepada bank untuk tolakan sebarang jumlah yang belum dibayar oleh pertubuhan kepada jumlah yang terhutang oleh syarikat persendirian - Samada pemberian ikrar dan surat tolakan ultra vires pertubuhan.* *g*

Isu didalam rayuan ini ialah samada pemberian ikrar dan kuasa untuk tolakkan oleh jawatankuasa pentadbir Koperasi Mercantile Thrift dan Loan Society Ltd. bagi pihak perayu bank berkaitan dengan amaun genap masa oleh sebuah syarikat persendirian yang ditubuhkan dibawah Akta Syarikat 1965 adalah *ultra vires* kepada pertubuhan dan dengan itu tidak mengikatnya. *h*

Diputuskan:
[1] Disebabkan tiada resolusi secara formal dari jawatankuasa pentadbiran, pertubuhan, yang memberi kuasa didalam mengeluarkan ikrar dan surat tolakan dan dimeteraikan dengan meterai (mohor) pertubuhan, ikrar dan surat tolakan semata-mata tidak mencukupi. *i*

[2] Ikrar berkenaan dan dokumen-dokumen tolakan dalam kes ini adalah komitmen kewangan yang tidak diliputi oleh s. 32 Akta Pertubuhan Koperasi1948 dan pertubuhan tiada kuasa untuk menyempurnakan dokumen dokumen berkenaan.

[3] Dengan ini, kedua-dua dokumen adalah *ultra vires* dan tidak sah dari awal lagi (*void ab initio*).

[Rayuan ditolak dengan kos.]

Cases referred to:

Malaysia Shipyard & Engineering Sdn. Bhd. v. Bank Kerjasama Rakyat Malaysia Bhd. [1985] CLJ (Rep) 206 ***(foll)***

In re Express Engineering Works Ltd. [1920] 1 Ch D 466 ***(foll)***

Legislation referred to:

Companies Act 1965, s. 5

Co-operative Societies Act 1948, ss. 4, 8, 30, 31, 32

For the appellant - C.V. Das (John Matthew with him); M/s. Shook Lin & Bok

For the respondent - A.D. Rajah (C.S. Khoo with him); M/s. Lovelace & Hastings

JUDGMENT

Harun Hashim SCJ:

The respondent (the society) was registered as a co-operative society on 17 March 1925. As a co-operative society it is subject to the provisions of the Co-operative Societies Act, 1948 (the Act), the rules made thereunder and its own by-laws. By s. 8 of the Act, such registration rendered the society a body corporate with powers to do all things necessary for the purposes of its constitution. By by-law 65 the control of the affairs of the society was entrusted to a committee of management consisting of eleven members who are required to elect one from among them to be the chairman of the committee.

On 20 December 1973 Muda Industries Sdn. Bhd. (Muda), was incorporated as a private company under the Companies Act 1965. Muda operated a shoe-factory on premises rented from the society. On the date of its incorporation, the subscribers to the memorandum of association and first directors were:

Haji Abdul Aziz bin Sood;
Paul Yu Yau Wah (of Hong Kong); and
Shamsul Azhar bin Abdul Aziz.

From 1973 (at least) Haji Abdul Aziz was the chairman of the management committe of the society. In early 1974, a decision had been made by the management committee to invest in Muda. It had paid a sum of RM10,500 for Muda's Project Feasibility Report and further sums amounting in all to RM120,000 to Muda by 28 March 1974 which payments were treated as the society's shareholding in Muda. In May 1974, the Registrar of Co-operative Societies gave his approval to the society that the said sum of RM120,000 be treated as an investment in Muda which amounted to 20% of the equity of Muda. It is also clear from the minutes of the meetings of the management committee, it discussed the affairs and progress of Muda as a regular item in its agenda. Of the 456,730 one ringgit shares in Muda, Haji Abdul Aziz as majority share-holder held 171,730 and was chairman of Muda. Three of the seven directors of Muda were members of the 1975 management committee of the society. Inspite of its sustained interest, Muda was not a subsidiary of the society as defined by s. 5 of the Companies Act.

In January 1975 Muda required cash but could not obtain overdraft facilities from the Bank of America. The society, however, had RM300,000 in fixed deposits with the Bank of America. In that month, arrangements were made for Muda to open an account with the appellants (the Chase Manhattan Bank N.A. - the bank); and the grant of overdraft facilities to Muda up to RM25,000. At the same time, the society transferred RM200,000 from its deposits with the Bank of America to the bank to be held as a fixed deposit and there being created what the bank understood to be a pledge by the society of such deposit against the facilities granted to Muda. It was also a condition of the bank accepting the fixed deposit that it would have a banker's lien on the deposited amount pursuant to which in the event the depositor became indebted to the bank, the bank was at liberty to set off the deposited sum or any part thereof against such indebtedness.

The bank was also provided with an undated letter purported to have been signed for the society by the chairman, the treasurer and one other committee member which purported to authorise the bank to set off any amounts standing to the credit of the society against any amounts owing by it or Muda. The signatories of the document are the authorised signatories of the society in respect of its own account with the bank. The document was stamped at the Stamp Office on 7 March 1975. In due course the Muda account being delinquent, the bank set off RM38,376.19 owing from the amounts standing to the credit of the society in fixed deposits. The bank informed the society of this on 20 November 1975.

In 1976, a new management committee of the society was elected. On 26 November 1976, the society's solicitors wrote to the bank protesting that the purported pledge and the purported authority that the bank could set off the amount due from Muda from the fixed deposits of the society were of no effect as being *inter alia ultra vires*. The bank refused to make good the amount. On 28 May 1977, the society caused a writ to issue seeking *inter alia* a declaration that the pledge and authority to set off were *ultra vires* the society and are not binding on it and for consequential orders for an account to be taken and for payment of the amounts found due and payable by the bank to the society on the taking of such account, interest and costs. The learned trial Judge held that the society was entitled to the declaration and gave orders in favour of the society. He dismissed the bank's counterclaim. Hence this appeal.

Is the giving of the pledge and letter of set-off *ultra vires* the society?

The society's records show:

> *The Mercantile Co-operative Thrift & Loan Society Ltd., Selangor.*
>
> Finance & Investment Sub-Committee Meeting - 4.35 p.m. Thursday, 16 January 1975.
>
> Present: Tuan Haji Abdul Aziz Sood (Chairman),
>
> Mr. Matthew Danker (Treasurer),
> Mr. K. Ramachandran, En. Supah H.M. Noh, Mr. A.M. John and
> Mr. W.R. Armstrong (Secretary).
>
> *Muda Industries:* The Chairman explains that this meeting has been called in connection with Muda's relationship with the Bank of America who say that, due to the present credit squeeze, they are unable to honour their promise of giving the company a long-term loan of RM200,000. The bank has in fact asked Muda to look elsewhere for the long-term loan. Muda presently has an overdraft of RM300,000 with the bank.
>
> Muda has been negotiating with the Chase Manhattan Bank for credit facilities and the bank has agreed to provide the necessary financial aid on condition that Muda brings in some business. It is noted that the society's current account is in credit to the extent of over

RM300,000 and in order to assist Muda it is decided to transfer the sum of RM200,000 to the Chase Manhattan Bank as a fixed deposit for a period of one year.

The meeting terminates at 5.05 p.m.

Sgd.

Secretary

This was followed by a letter to the bank on 17 January 1975.

The Manager,
The Chase Manhattan Bank,
Jalan Gereja, Kuala Lumpur.

Dear Sir,

Fixed Deposit RM200,000

We are placing the sum of RM200,000 on fixed deposit with your bank for a period of one year and we enclose a cheque for this amount. Please let us have your acknowledgment in due course.

Yours faithfully,
For the Mercantile Co-operative
Thrift & Loan Society Ltd.

Sgd.
Secretary

The pledge:

Kuala Lumpur 17 January 1975

The Manager,
The Chase Manhattan Bank,
Kuala Lumpur.

Dear Sir,

The Finance Sub-Committee authorises and agrees to pledge the fixed deposit of this society against facilities requested to be given to Muda Industries (S) Berhad.

Yours faithfully,

Chairman	:	Sgd.
Treasurer	:	Sgd.
Com. Member	:	Sgd.
Com. Member	:	Sgd.

The Letter of Set-off:

To: The Chase Manhattan Bank, N.A. Malaysia.

In consideration of your agreeing at my/our request not to require immediate payment of such sums hereinafter mentioned as may now be due and in consideration of any like sums which you may hereafter advance or permit to become due I/we agree that any monies from time to time standing to my/our credit on any account with you anywhere may be retained and at any time without notice to me/us applied by you in or towards payment or satisfaction of any sums of money now or hereafter from time to time due or owing to you (whether presently payable or not) by me/us and/or Messrs Muda Industries (S) Berhad whether alone or jointly with any other person firm or corporation or otherwise and whether as principal or surety anywhere upon banking account or upon any discount or other account or for any other matter or thing including the usual banking charges. This is to be in addition and without prejudice to any securities you may now or hereafter hold.

Yours very truly,

For the Mercantile Co-operative
Thrift & Loan Society Ltd.

Sgd. Sgd.
Chairman Hon. Treasurer

Sgd.
Committee member

The bank's letter to Muda granting the facility is in the following terms:

21 January 1975

Muda Industries Sdn. Bhd.
No. 1, Jalan 51/201,
Petaling Jaya,
Selangor.

Attention Encik Shamsul Azhar Aziz

Gentlemen,

We are pleased to advise that we have approved the following facility to your company as requested in your letter dated 20 January 1975.

Overdraft facility	: RM25,000
Interest rate	: 14½% per annum
Period	: 3 month, commencing 21 January 1975 expiring 21April 1975.
Security	: Collaterized by Certificate of Deposit No. 4996 in the name of the Mercantile Co-operative Thrift & Loan Society Ltd. dated 20 January 1975 and expiring 20 January 1976 in the amount of RM200,000.

It was agreed that the facility granted above is a temporary accomodation from us to tie you over in your immediate needs. As you know, we are now looking into the operation of your company to see how best we can be of assistance. We are incorporating all the facts and figures you have given us, and as soon as we have reached a decision we shall revert to you.

Sincerely,

Sgd.	Sgd.
Daniel A. Reid	Idris Tulis
Second Vice President & Manager	Assistant Manager Credit & Marketing

It will be noted that the authorised signatories of both the society and Muda in respect of banking transactions are the same persons.

The crux of the society's case is contained in para. 4 of the amended statement of claim in the following terms:

> The society will plead that the above purported agreements are, under ss. 4, 8, 30, 31 and 32 of the Co-operative Societies Act 1948 and the rules and by laws made thereunder, *ultra vires* the society and it was beyond the capacity of the society to enter into such transactions and the Finance Sub-Committee and the Chairman had no power express or implied to execute such purported agreements with the intention of binding the society and in consequence the society is not bound by such agreements.

It is standard banking practice that before an overdraft facilty is granted to or a guarantee (pledge) is accepted from a body corporate that there should be a formal **resolution** of the board of directors (or committee of management in the case of a society). This was done in the case of the Muda overdraft facility as set out in the extract of the minutes:

> *Banking Account*
>
> The meeting resolved that an account be opened with Chase Manhattan Bank, No. 9, Jalan Gereja, Kuala Lumpur in the name of the Company and that any formal resolution which the said bank might prescribe for the opening of accounts be adopted as though set out herein, that the bank be authorised to pay cheques, bills of exchange, promissory notes, etc., signed by any one of the following two signatories namely Encik Shamsul Azhar bin Abdul Aziz and Encik Ramachandran and to be countersigned by Tuan Haji Abdul Aziz bin Sood.
>
> The meeting further resolved that Chase Manhattan Bank, No. 9, Jalan Gereja, Kuala Lumpur be requested to furnish to the Company overdraft facility to the extent of RM300,000 and a fixed loan of RM200,000 for purpose of working capital of the company's business which facility shall be guaranteed by the directors.
>
> Dated: 16 January 1975.

However, there is no such resolution in respect of the pledge and letter of set-off given by the society, that is to say, that the pledge and letter of set-off standing by themselves are insufficient. There should have been a formal resolution of the committee of management of the society authorising the issue of the pledge and letter of set-off and sealed with the seal of the society. The bank's manager who gave evidence at the trial was aware of this banking practice and said that:

> In the case of a company without the resolution of the board of directors we would not accept the pledge.

In the case of a co-operative society, however, he said:

> I don't really know. I have not dealt with a co-op. society. I suppose I would have sought legal advice on the point.

In the instant case, the by-laws of the society had been deposited with the bank. By-law 75 provides:

> All important documents shall be sealed with the seal of the Society, which shall be kept in the safe custody of the Secretary.

And By-law 76 reads:

> All receipts and documents, the execution of which has been authorised by General or Special resolution of the Committee or General Meeting, shall be signed by the Chairman, Treasurer and one Committee member on behalf of the Committee, and the Society shall be bound by such signatures, provided that the Treasurer may sign receipts up to RM200.

By-law 67 sets out the duties and powers of the management committee which does not allow the giving of pledges and set-offs. The absence of a sealed resolution from the society should have put the bank on the alert to safeguard its own interests particularly as Muda is neither a subsidiary nor a member of the society.

Be that as it may, whether the pledge and letter of set-off are *intra vires* or *ultra vires* depends not on the by-laws of the society but on the Act and the rules made thereunder. That this is so is clearly illustrated by the case of *Malaysia Shipyard & Engineering Sdn. Bhd. v. Bank Kerjasama Rakyat Malaysia Bhd.* [1985] CLJ (Rep) 206, a decision of this Court

constituted of five Judges. All five Judges were unanimous on this point. In that case, the respondents (also a co-operative society) had given a guarantee by which they agreed to indemnify the appellants in the event a third party company failed to perform its contract with the appellants. The third party failed to perform its contract, whereupon the appellants terminated the contract and thereafter sued the respondents upon the guarantee. On the validity of the guarantee, however, three of the Judges held the guarantee was *ultra vires* and *void ab initio*. The other two dissenting Judges held the guarantee was *intra vires*. The appellants contend that *Malaysia Shipyard & Engineering* can be distinguished with the instant case on the facts. It is said that the majority decision was right because there was no *nexus* between the co-operative society that gave the guarantee and the third party which was the beneficiary of the guarantee whereas here the *nexus* was pre-existing between the society that gave the pledge and Muda which enjoyed the benefit of the pledge because the society had an equity in Muda. Further, the Registrar of Co-operative Societies had approved the investment in Muda; the performance of Muda had been reported at every meeting of the management committee of the society; and that all cheques issued by Muda had to be co-signed by a member of the management committee of the society. As the finance sub-committee that gave the pledge consisted of the principal members of the management committee of the society, it was urged that it is not open to the society to say that the approval was given by a committee wearing the wrong hat as the same persons are involved on the authority of *In re Express Engineering Works, Ltd.* [1920] 1 Ch D 466.

We do not think that case applies to the facts of this case as there the five directors of the company were also the sole shareholders of the company and they were selling the debentures to themselves and did not involve any third party. The contract for the sale and issue of the debentures was carried out at a meeting of the five and was styled a board of directors meeting in contravention of the articles of the company which provided that no director should vote in respect of any contract or arrangement in which he might be interested. But they could effect the transaction as shareholders. Warrington LJ said at p. 471:

> In as much as they could not in one capacity effectually do what was required but could do it in another, it is assumed that as businessmen they would act in the capacity in which they had power to act. In my judgment they must be held to have acted as shareholders and not as directors, and the transaction must be treated as good as if every formality has been carried out.

In the present case the situation is entirely different. Muda is neither a subsidiary nor a member of the society. The fact that the society holds 20% of the equity of Muda or that some of the directors of the society are also directors of Muda and personally hold shares in Muda do not create the necessary *nexus* between the society and Muda so as to bind the society in the impunged transactions. It did, however, create the opportunity for the directors of the society to do what they did. They have simply abused their positions. Even under the society's by-law 76 they had no authority whatsoever, as a finance sub-committee, to execute the two documents, as such documents, if at all, can only be authorised by the committee of management or the general meeting. As between the society and the directors concerned, we are of the view that the directors acted in their personal capacities and are therefore personally accountable to the society for any loss of the society's funds.

The next question is, how does all this affect the bank? From what we have said, Muda is clearly a third party beneficiary in the aforesaid transactions and falls squarely in the same position as the third party beneficiary in the *Malaysia Shipyard and Engineering* case (*supra*). Whether the society had the power to give the pledge here is governed by the Act. Salleh Abas LP (as he then was) said in *Malaysia Shipyard and Engineering* at p. 209:

Section 30 clearly empowers the respondents to give loans and even so the power is restricted to the giving of loans to certain classes of borrowers only, namely only to those connected with the respondents. Section 31, on the other hand, empowers the respondents to borrow from non-members in the form of receiving deposits and loans from them, and here again the borrowing power is limited to the extent and conditions prescribed by the rules and by-laws. The giving of a guarantee is neither giving nor receiving loan. It is a distinct and separate kind of dealing altogether. Although a guarantee purports to create liability on the surety, in no sense could it be said that the surety is borrowing the guaranteed sum from the creditor (the person to whom the guarantee is given) or giving a loan of that amount to the principal debtor (the person for whose advantage the guarantee is given). [See *In Re Queen Anne and Garden Mansions Co.*] (2). Thus, since a guarantee is neither a loan nor a borrowing, both ss. 30 and 31 do not apply to the giving of a guarantee by the respondents.

It was urged upon us that the pledge and set-off here are **transactions** and are therefore permitted by s. 32 of the Act. That section reads:

Save as provided in ss. 30 and 31 the transactions of a registered society with persons other than members shall be subject to such prohibitions and restrictions as may be prescribed by the rules.

As to this Abd. Hamid CJ (Malaya) (as he then was) said in *Malaysia Shipyard and Engineering* at p. 214:

The word “transactions” is not defined. The question is can it be construed to cover any transaction whatsoever with non-members? I do not think so. My view is that the law only allows those transactions which, expressly or impliedly, come within the scope of the Act or rules made under and in accordance with s. 51 of the Act.

To decide therefore whether the word "transactions” used in the section covers such a guarantee, the exact nature of a guarantee must be determined. First, what is a “guarantee”? It is defined in the *Shorter Oxford English Dictionary*, in relation to fund, to mean “a sum of money pledged as a contingent indemnity for possible loss”. The same word is defined in Words and Phrases Legally Defined to mean “an accessory contract, whereby the promisor undertakes to be answerable to the promisee for the debt, or miscarriage of another person, whose primary liability to the promisee must exist or be contemplated.” As can be seen, a guarantee is a transaction, in effect it is a contract whereby the respondent accepts a commitment making itself liable to pay a sum of money upon the happening of a certain event. In essence, it is a contingent liability. As it is basically a financial commitment involving the payment of money, immediate or otherwise, the power so to do must, in my view, be properly sanctioned by the Act. Any contention that s. 32 of the Act sanctions a transaction of this nature would conceivably be placing too wide a construction ignoring the fundamental objects of the society which is to promote the interest of its members in accordance with co-operative principles as set out in s. 4 of the Act.

We are of the view that the pledge and set-off documents in this case are financial commitments which are not covered by s. 32 of the Act. The society has no power to execute such documents. We accordingly hold that both documents are *ultra vires* and *void ab initio*.

The appeal is dismissed with costs. Deposit to respondent to account of taxed costs.

Also found at [1992] 3 CLJ 1346